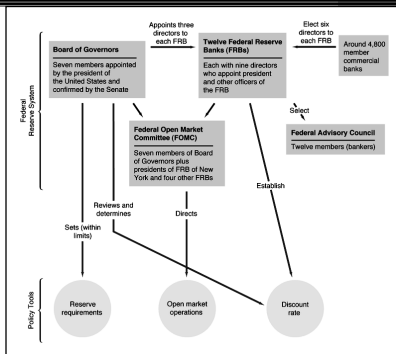# Chapter 14

Structure of Central Banks and the Federal Reserve System

Need for a Central Bank

- Before 1913
  - general resistance against centralization of powers and moneyed interests
  - no lender of last resort ⇒ regular bank panics
- Case against a central bank
  - Wall Street interests could gain control over the economy
  - federally operated, so too much government intervention
- Debate on whether the central bank should be privately run or a government institution ⇒ current form is a compromise
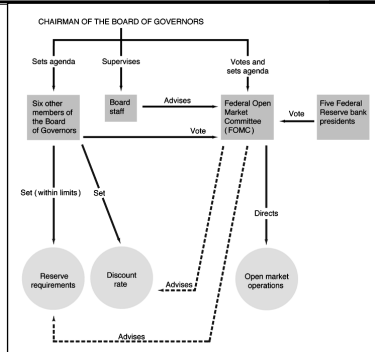

Formal Structure of the Fed

Federal Reserve Districts

Informal Structure of the Fed

Central Bank Independence

- Factors making Fed independent
  - members of the Board have long (non-renewable) terms
  - financially independent (most important)
  - ⇒ Fed is *instrument-independent* (can set monetary policy instruments) and *goal-independent* (can set goals of monetary policy)
- Factors making Fed dependent
  - Congress can amend Fed legislation
  - President appoints Chairmen and Board members and can influence legislation
- Overall: Fed is quite independent

Independence of Other Central Banks

- Bank of England is least independent: government makes policy decisions
- European Central Bank: most independent—price stability is its primary goal
- Bank of Canada and of Japan: fair degree of independence, but not all on paper
- trend to greater independence: New Zealand, other European nations

Explaining Central Bank Behavior

- Theory of bureaucratic behavior
  - is an example of the principal-agent problem
  - bureaucracy often acts in own interest

- Implications for Central Banks:
  - act to preserve independence
  - try to avoid controversy: often plays games
  - seek additional power over banks

Should the Fed be Independent?

- Case "for"
  - an independent Fed likely has longer-run objectives, politicians don't: evidence is independence produces better policy outcomes
  - avoids political business cycle
  - less likely that deficits will be inflationary

- Case "against"
  - Fed may not be accountable
  - hinders coordination of monetary and fiscal policy
  - Fed has often performed badly

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